

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

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FISCAL IMPACT STATEMENT

LS 6472

BILL NUMBER: SB 78

DATE PREPARED: Jan 14, 2001

BILL AMENDED:

SUBJECT: Local Option Inventory Tax Relief.

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FUNDS AFFECTED: ☒ **GENERAL**
☒ **DEDICATED**
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill allows the county fiscal body to phase out the property tax on inventory by allowing assessed value deductions in five increasing gradations over a ten-year period. It reduces the property tax levies of all taxing units having assessed value in an adopting county.

The bill also allows the county fiscal body to adopt an ordinance imposing an income tax to recover the net property tax revenue lost by the phase out of the property tax on inventory. It provides that the income tax will increase over the ten-year period to recover the revenue lost by each increase of the assessed value deduction. This bill requires the State to distribute revenue to income tax adopting counties to replace property tax replacement credits and it makes an appropriation.

Effective Date: January 1, 2002.

Explanation of State Expenditures: The State's expense for property tax replacement credits (PTRC) could be reduced under this proposal. If a county adopts the property tax deduction for inventory without imposing the Inventory Tax Replacement Income Tax, the state would not pay the 20% PTRC on the deducted amount.

The State Department of Revenue would have additional expenses for collecting and distributing the Inventory Tax Replacement Income Tax under this proposal.

Explanation of State Revenues: The State levies a one cent tax rate for State Fair and State Forestry. Any reduction in the assessed value base will reduce the property tax revenue for these two funds. Based on the estimated loss of inventory assessed value exempted by this proposal, state property tax proceeds will be reduced by a maximum of \$111,000 in CY 2003 to approximately \$831,000 in CY 2012, assuming that all counties adopt the inventory tax phase-out in the first year available.

Explanation of Local Expenditures:

Explanation of Local Revenues: (Revised)

Inventory Deduction

This proposal would authorize counties to adopt an ordinance to phase out the property tax on inventory. If adopted, taxpayers would receive a deduction against the assessed value (AV) of their inventory. The amount of deduction is equal to 20% of the inventory in years 1 and 2, 40% in years 3 and 4, 60% in years 5 and 6, 80% in years 7, 8, and 9, and 100% in year 10 and each year thereafter. A county would be allowed to pass an ordinance repealing the deduction only after the deduction has been in effect in the county for at least ten years.

If a county elects to phase out the property tax on inventory, the maximum levy of each civil taxing unit in the county would be reduced to reflect the loss of valuation. Likewise, school General Fund levies would also be reduced. The school General Fund levy adjustment would be made after computations are made for state tuition support, eliminating any reduction of state support. The civil unit maximum levy and school General Fund levy adjustments would keep the tax burden from shifting from the inventory owners to all other taxpayers via an increased tax rate. Instead of a shift, local units would lose the tax revenue attributable to property tax on inventory.

Estimation Issues: In estimating the impact of this bill, special attention was given to the impending real property reassessment. The final rules on real property assessment will have a direct impact on property tax rates and the amount of the property tax levy that will be attributed to inventory. Reassessment will shift some of the property tax burden from personal property owners to real property owners. Due to the uncertainty surrounding the next reassessment and the amount of the shifts, this analysis projects the tax value of the inventory AV deduction within a range, using a small reassessment shift and a large reassessment shift. The estimated shifts are based on projected increases in total assessed value. The smaller total assessed value increase of 25% was based on previous Indiana reassessments while the larger total assessed value increase of 80% was based on the estimated impact of reassessing property using a market value approach. It was also assumed that the next reassessment will apply to property assessed in 2002 with taxes first paid in 2003 as mandated in the latest order from the Indiana Tax Court.

Data: According to the State Tax Board's Property Tax Analysis for various years, the net property tax on inventory equaled \$402 M in CY 1999. The 1998 pay 1999 inventory assessed value was \$4.5 B and has grown at an average annual rate of 4.9% over the last five years. The statewide net average property tax rate was \$8.5549 per \$100 AV in CY 1999 and \$8.6955 per \$100 AV in CY 2000.

Fiscal Impact: Future inventory assessed values were projected based on historical data and were then reduced to account for credits. Future average net property tax rates were also estimated. Based on estimates of future total tax levies and total assessed values, it is estimated that the statewide average net tax rate will grow at a rate of about 2% per year in non-reassessment years. An estimate of the future net property tax on inventory was then computed by multiplying the estimated net assessed value of inventory by the estimated net average tax rates.

The table below shows the *estimated* reductions in gross property tax levies and inventory taxpayer savings (net levy reductions) *assuming all counties adopt ordinances in CY 2002* to phase out the property tax on inventory beginning in CY 2003. The amount of state PTRC shown is the estimated amount of property tax replacement credits that the state would not have to pay under the bill as a result of the reduction of civil unit maximum levies and school General Fund levies. However, the state would pay this same amount in PTRC if the Inventory Tax Replacement Income Tax under this bill is adopted. There would probably be no change

to overall PTRC expenditures assuming that all counties that adopt the inventory deduction also adopt the replacement tax.

(In Millions)					
Year	Property Tax Year	Deduction Percentage	Gross Levy Reduction*	Net Levy Reduction*	State PTRC*
1	2002 Pay 2003	20%	\$67 - \$97	\$58 - \$83	\$9 - \$14
2	2003 Pay 2004	20%	\$72 - \$103	\$62 - \$89	\$10 - \$14
3	2004 Pay 2005	40%	\$153 - \$220	\$132 - \$190	\$21 - \$30
4	2005 Pay 2006	40%	\$156 - \$224	\$134 - \$193	\$22 - \$31
5	2006 Pay 2007	60%	\$250 - \$359	\$215 - \$310	\$35 - \$49
6	2007 Pay 2008	60%	\$266 - \$383	\$230 - \$330	\$36 - \$53
7	2008 Pay 2009	80%	\$379 - \$544	\$327 - \$470	\$52 - \$74
8	2009 Pay 2010	80%	\$386 - \$554	\$334 - \$479	\$52 - \$75
9	2010 Pay 2011	80%	\$411 - \$591	\$356 - \$511	\$55 - \$80
10	2011 Pay 2012	100%	\$549 - \$788	\$475 - \$682	\$74 - \$106
*- Assumes that all counties would adopt the phase-out in the 1st year available.					

Although this analysis assumes that reassessment will be effective for property taxes paid in 2003, further legal action could delay the effective date. For this reason, the net levy reduction was also estimated assuming that reassessment would not take place. Without reassessment, the net levy reduction under this bill could be as high as \$930 M by 2012.

Based on the estimated growth rates of inventory assessed value and net property tax rates, the net levy reduction under both the "2003 reassessment" and the "no reassessment" assumptions is estimated to grow at about 6% to 7% per year after FY 2004.

Inventory Tax Replacement Income Tax

Counties that choose to phase out the property tax on inventory may impose the Inventory Tax Replacement Income Tax, which is created by this bill. The tax would be a local option income tax on the adjusted gross income of individual taxpayers residing in the county.

County Councils are to use data compiled by the State Tax Board to determine the appropriate income tax rate in the first year. The tax rate will automatically increase by the amount of the initial rate every two years through the tenth year. The rate may be reduced by ordinance as long as none of the tax revenues have been pledged for the payment of bonds.

Proceeds from the tax are to be deposited in the counties' Inventory Tax Replacement Accounts within the State General Fund. Interest income would be deposited into the Counties' accounts. The Department of

State Revenue, on recommendation of the State Budget Agency, would estimate and certify the amount of income tax that will be collected during the following year.

Inventory Tax Replacement Income Tax proceeds will be distributed to the adopting counties in equal parts on May 1 and November 1. The tax would take effect on July 1 of the year in which it is adopted. This will allow six months of revenue to build up in the fund so that cash is available to make the distributions. Each taxing unit in an adopting county would receive a proportionate share of the replacement revenue.

In the first year that a county adopts the Inventory Tax Replacement Income Tax, each county would have its income tax rate set so that the new tax does not generate any more revenue than the amount of the net levy attributable to the inventory deduction. It is estimated that a 1% income tax would generate about \$1.347.3 B statewide in CY 2002. Assuming a 4% growth rate, the income tax generated from a 1% rate in CY 2003 is estimated at \$1.40 B. Assuming that all counties would adopt the Inventory Tax Replacement Income Tax in CY 2002 (the 1st year available), approximately \$58 - \$83 M would be needed from this tax to offset the property tax loss. The statewide average of the county income tax rates needed to raise \$58 - \$83 M in CY 2003 is estimated to be 0.041% - 0.059%. Based on this initial tax rate, the statewide average of the county income tax rates in the tenth year (when the phase-out is complete) would be about 0.21% - 0.30%.

Each individual county's rate would differ from this average depending on the amount of inventory in the county, the property tax rate, and the wealth of the income tax base. It is not currently known if the income tax revenues will grow at the same rate as the loss of property tax. If a county collects more in income tax than it loses in property tax, then there would be a revenue increase in the county. Likewise, if a county receives less revenue from the income tax than it loses in property tax, then there would be a revenue reduction.

The state will pay PTRC on the amount collected via the replacement tax. The PTRC percentage will equal the average county PTRC percentage. PTRC is paid from the Property Tax Replacement Fund, which is supplemented by the state General Fund.

If the income tax is adopted by a county then this bill would have the effect of shifting businesses' property tax on inventory to individuals and businesses who are liable for the individual adjusted gross income tax.

State Agencies Affected: State Board of Tax Commissioners; Indiana Department of State Revenue; State Budget Agency; Auditor of State.

Local Agencies Affected: All taxing units in adopting counties.

Information Sources: State Board of Tax Commissioners, Property Tax Analysis, various years; Local Government Database; Department of State Revenue; December 19, 2000 Revenue Forecast.